

Service Date: December 20, 1983

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF Montana

IN THE MATTER of the Application of	)	UTILITY DIVISION
MONTANA-DAKOTA UTILITIES	)	
COMPANY for Authority to Implement	)	DOCKET NO. 83.5.34
the Gas Cost Tracking Adjustment	)	
Procedure.	)	ORDER NO. 4993b

APPEARANCES

FOR THE APPLICANT

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FOR THE MONTANA CONSUMER COUNSEL

John C. Allen, Consumer Counsel Staff Attorney, 34 West Sixth Avenue, Helena,  
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FOR THE INTERVENORS

Jerome Anderson, Attorney at Law, Anderson, Brown, Gerbase, Cebull & Jones, P.C.,  
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Company

C.W. Leaphart, Jr., Attorney at Law, The Leaphart Law Firm, 1 North Last Chance  
Gulch, #6, Helena, Montana 59601, appearing on behalf of Great Western Sugar  
Company and Holly Sugar Company

FOR THE COMMISSION

Robert Nelson, Staff Attorney  
Dan Elliott, Administrator, utility Division

BEFORE:

THOMAS J. SCHNEIDER, Chairman  
JOHN B. DRISCOLL, Commissioner  
DANNY OBERG, Commissioner

FINDINGS OF FACT

1. On May 2, 1983, Montana-Dakota Utilities Company (MDU, Company, or Applicant) filed with the Montana Public Service Commission (PSC) its biannual application to implement the Gas Cost Tracking Procedure as set forth in MDU Tariff Sheets 87-M and 88-M.

2. The tracking procedure provides for increasing rates on the basis of a Current Gas Cost Tracking Adjustment and an Unreflected Gas Cost Adjustment amortized over a projected six-month sales period. The application provided two alternative proposals by MDU to determine the amount of adjustment. The first proposal is per Tariff Rate 88 and the resulting increases are based on the following adjustments:

	Residential and <u>Commercial</u>	Industrial <u>Customers</u>
Current Gas Cost Adjustment	47.6¢	51.7¢
Unreflected Gas Cost Adjustment	84.1¢	84.1¢
Less: Total Tracking Adjustment		
Effective Through May 31, 1982	<u>68.5¢</u>	<u>69.5¢</u>
Net Increase in Current Rates	<u>63.2¢</u>	<u>66.3¢</u>
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3. In the second proposal, MDU requests a waiver of the six month provision of Rate 88 so that an alternative unreflected gas cost adjustment 12 months may be implemented for this filing. The resulting increases for this alternative proposal are based on the following adjustments:

	Residential and <u>Commercial</u>	Industrial <u>Customers</u>
Current Gas Cost Adjustment	47.6¢	51.7¢
Unreflected Gas Cost Adjustment	30.6¢	30.6¢
Less: Total Tracking Adjustment		
Effective Through May 31, 1982	<u>68.5¢</u>	<u>69.5¢</u>
Net Increase in Current Rates	<u>9.7¢</u>	<u>12.8¢</u>
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4. In its application, the Company requested that the adjustments be implemented in full on an interim basis. On June 22, 1983, the Commission issued Interim Order No. 4993, authorizing interim increases of .4 cents for residential and commercial customers and 3.5 cents for industrial customers. Adjustments were made for levels of off-system sales and company production. Following MDU July 1, 1983 Motion for Reconsideration, the Commission eliminated the off-system sale adjustment, replacing the .4 cents and 3.5 cents with 4.2 cents and 7.3 cents, respectively. The Commission declined, however, to eliminate the company production adjustment for purposes of interim relief.

5. Following issuance of notice, a public hearing was held on July 14, 1983, in the courtroom, Federal Building, U.S. Courthouse, Billings, Montana.

6. Past Commission orders establish several criteria (listed in Interim Order No. 4993) for gas cost tracking adjustments. The single significant issue in this application revolves around the

requirement that tracking procedures be based upon the gas mix last approved in a general rate case, with respect to both current costs and the unreflected gas cost account. MDU has deviated from this course with a drastic reduction of company production.

7. In the last general rate case, Docket No. 82.6.40, Phase I, Order Nos. 4918b and c, the Commission approved a gas mix which includes 4,259,057 Mcf of company production. MDU current goal for company production is 1 Bcf, or less than one-fourth the Commission approved level.

8. As noted above, the Commission adjusted interim rates in this application to eliminate the effects of the Company's new production levels. This was done for several reasons. It is axiomatic to ratemaking that a utility seeking to increase its rates bears the burden of demonstrating that its expenses contributing to those rates are reasonable. When gas utilities requested expedited relief from rapidly increasing gas costs, the Commission sought to reconcile that expedited treatment with standard ratemaking principles, including reasonableness of expenses. One of the necessary requirements was that gas mix would be considered separately in general rate cases and applied as a formula in tracking applications. This would allow immediate consideration of the company's per-unit cost of gas. MDU has been aware of this requirement from the time it requested a tracking adjustment, and submitted tariffs implementing such a procedure.

9. In Docket No. 82.6.40, I, Order No. 4918c, the Commission reviewed these considerations in view of MDU's motion to reconsider the approved level of company production. The Commission first concluded that no showing was made to justify altering MDU's gas mix. In recognition of off-system sales losses and in fairness to the Company,

however, it was reluctantly agreed to depart from normal practice and reexamine company production levels in this tracking application.

10. MDU now claims that the Commission lacks authority to review gas mix. Relying on the integrated nature of its system, the Company asserts that such state regulation is a burden on interstate, commerce, and is preempted by Federal regulation. The Commission is compelled to reject these arguments.

11. The Commission is not persuaded that a Commerce Clause analysis is applicable in this case. Although it is well established that Congress may regulate in this arena if it so chooses, the extensive body of statutes and regulations on the subject fairly delineates the extent of Federal intrusion. The issue seems more properly cast in terms of Federal preemption. In addition, the Commerce Clause standards, if applied, would not prevent Commission approval of a proper gas mix. The Commission's regulation in this area is not discriminatory, it erects no trade barriers and it deals with a subject of traditionally local concern. MDU has not specified the burden on interstate commerce which concerns it, and the Commission can conceive of none. Moreover, the benefits of traditional state regulation of monopolies and utility service must be considered.

12. MDU further contends that the Commission is preempted from exercising jurisdiction over company production. Several cases are cited for the proposition that the Federal Energy Regulatory Commission (FERC) has exclusive jurisdiction over all aspects of the movement and sale of natural gas in interstate commerce. This statement, while perhaps essentially true, is deceptively simplistic. The issue here is whether this Commission can examine the reasonableness of the Company's gas acquisition policy, which is a major determinant in the expenses reflected in local retail distribution rates. We believe that the answer must be yes. This

has long been a key state power in regulating utility rates, and one which was not upset when Congress enacted the Natural Gas Act to complement state regulation. The Company has cited no authority which leads us to believe otherwise.

13. Turning from jurisdictional arguments, MDU next contends that the Commission's interim company production adjustment is confiscation of property in violation of the due process requirement of the Fourteenth Amendment to the United States Constitution. Again, basic principles of utility regulation provide some guidance. It has often been stated that one devoting property to a use affected with the public interest must also submit to public control to the extent of the interest created. This principle is explicitly recognized in Montana law. Of course, the extent of regulatory control has been a frequently challenged issue, resolved on a case-by-case basis.

14. The Commission believes scrutiny of gas expenses is essential to protect ratepayers. The record in this case is a striking display of this need. It is readily apparent that MDU's gas acquisition policy has lead to a dire oversupply situation which threatens to significantly penalize ratepayers. Even with a 75 percent reduction in company an uncertain 13 Bcf off-system sale, and a 44 percent reduction in take-or-pay requirements, MDIJ has a supply of 3 Bcf in excess of its market. The impact of this situation on Montana ratepayers is undeniably great, and the Commission does not accept the proposition that it is powerless to act, merely because the problem is the result of managerial decisions. Indeed, we would be remiss in our statutory obligations if we did not monitor these developments and attempt to bairnce ratepaver and shareholder interests.

15. The Commission is disturbed by MDU assertion that failure to allow "known expenses" is impermissible confiscation because it forces the Company to absorb those costs. We

emphatically reject this proposition. Even the authority MDU cites does not support this argument. The Commission stresses that only properly incurred i.e., reasonable, expenses must be reflected in rates; moreover, the Company bears the burden of showing the reasonableness of its expenses.

16. Finally, MDU argues that any adjustment for company production in this case would be arbitrary and capricious and retroactive ratemaking. This contention is based on MDU's interpretation of tariffed Rate 88, "Gas Cost Tracking Adjustment Procedure." The Company cites the following language from the six page tariff:

Annual Volumes to be Utilized The volume of gas to be utilized shall be the actual volume of purchased, storage and produced gas, exclusive of gas sold to Frontier Gas Storage Company, recorded for Seller integrated system during the twelve-month period ending on the January 31 and July 31 next preceding the adjustment dates of June 1 and December 1 of each year.

17. Two points should be noted with respect to the above tariff language. First, Section 3(c)(1)(iii) of the tariff states that the cost per Mcf of gas "shall be applied to the purchased and storage volumes as last approved by the Commission and such result shall be adjusted to reflect the volume of produced gas as last approved by the Commission at no cost." Clearly, the tariff contemplates adherence to a Commission-approved gas mix. To allow some flexibility to the Company, the mix is stated on an annual basis, rather than in monthly or semi-annual periods to suit the gas cost tracking procedure. As noted in the Commission Order on Motion for Reconsideration regarding the interim order in this Docket, however, MDU has no intention of adhering to the Commission-approved mix. In fact, the Company's new production levels are readily apparent in the last three months of the period under consideration here.

18. It must also be noted that the annual volume provision applies only to the current gas cost tracking procedure, not the unreflected purchased gas cost account, MDU rigid

interpretation of the tariff provisions implies that the Commission gas mix requirement does not apply at all to this account. Under these circumstances, the Commission believes that it cannot ignore the fact, as MDU urges us to, that company production levels in both the current and unreflected gas cost adjustments do not reflect an approved gas mix.

19. As noted above, the Commission recognizes MDU serious over supply problem. This appears to be the result of several factors, not the least of which is the Company's aggressive gas purchase and storage policy which has been the source of Commission concern for some time. The Commission was encouraged when MDU found off-system customers to purchase the excess supply. As discussed in this proceeding and in Docket No. 82.6.40, however, this solution quickly evaporated, bringing with it additional potential problems. The Commission concluded in Order NO. 4918b, Finding No. 72, that both the Company and its Montana ratepayers had stood to benefit from the off-system sales.

20. To balance gas supplies with gas markets in view of the off-system sale reduction, MDU reduced its purchases by 44 percent from minimum take or-pay levels. The typical take-or-pay requirement is 75 percent. The Company reduced company production much more than 44 percent of its last approved mix level to 1 Bcf, or the bare minimum necessary to protect its leases.

21. In view of the shared benefits which prompted the off-system sales, the Commission believes that the current burdens of the supply problem should likewise be shared. The course MDU is pursuing with respect to company production, however, appears to ignore this philosophy, and places a disproportionate burden on the ratepayer. The Commission concludes that company production should be treated just as MDU is treating its other sources of supply; that is, current company production should be reduced by no more than 44 percent. This approach will treat the last approved reasonable annual production level, 4,259,057 Mcf, as a

close approximation to 75 percent of MDU's production capability. The resulting new reasonable level of annual company production will be 2,385,072 Mcf (.56 X 4,259,057).

22. The Commission tested the reasonableness of company production included in its filing against 50 percent of 2,385,072 Mcf. A 50 percent level was used because MDU historically has taken about 50 percent of its company production in each of the six month tracking periods MDU included 1,361,325 Mcf which was 168,789 Mcf more than the 1,192,536 Mcf floor established by the Commission. The Commission finds MDU's' company production level reasonable. It should be noted that the floor established in this order will be used to test the reasonableness of company production included in future applications.

23. During the hearing, Company witnesses established that MDU had asked its producers to accept a 44 percent cutback in MDU purchase levels because its supply was substantially in excess of its market. The cutback was made based upon November, 1982 purchased volumes. Subsequently, however, the Con discovered that it should have cut back its producers substantially more than 44 percent to reflect conditions it was unaware of during November, 1982. The most significant of these conditions is the Company's surprisingly large miscalculation of deliverability under its contracts with producers.

24. The additional excess volumes were manifested on MDU's Exhibit A, p. 15 of 15. Line 28 amounts are labeled "Gas Subject to Cutback or Possible Sale," and constitute 13,000,000 Mcf's at 14.73 psia with a valuation of \$40,532,050. The Commission, however, has not been notified of any off- system sales nor additional cutbacks in purchases. At the time of the hearing, the excess deliverability was being injected into Company storage reservoirs.

25. To ensure that ratepayers do not bear more than their fair share of MDU's current Supply problems, the Commission is of the opinion that, regardless of whether the excess is sold,

placed into storage or not taken, the logical, economic approach dictates that the most costly sources of supply be eliminated first from current gas cost purchase expense. This should be accomplished by excluding volumes associated with the highest cost gas from current gas cost expense, until the excess level of 13 Bcf is reached. MDU has previously used this approach for off-system sales, in order to mitigate the impacts of current excess deliverability.

26. MDU should not accumulate additional storage. The Commission believes that existing storage may be far more than adequate for the foreseeable future, and that further additions would unnecessarily burden rate payers. The Company is admonished to match future purchases and production with existing markets. It appears that if MDU does not pursue further supply reductions, it will only be adding to serious concerns regarding the used and usefulness of its vast storage reserves.

27. Compounding these problems, NGPA provisions have produced market inefficiencies resulting in MDU purchase of gas priced at \$8.35/Mcf (Exh. A, p. 5, 1. 8) at a time when the price of a competitive fuel, #6 fuel oil, is \$3.20 (Tr. p. 60, 11. 4-6). Because of the dramatic effect these inefficiencies have had on gas supply and, in turn, on ratepayers, the Commission takes this opportunity to place MDU on notice that it will not tolerate these excess high priced sources in future cases.

28. Consistent with the discussion above, the Commission will order MDU to file future cases reflecting Exh. A with the highest priced sources of supply allocated to the Category "Gas Subject to Cutback, Possible Sale or Incremental MDU Storage."

29. Finally, the Commission concludes that we should re-examine the necessity of a tariffed gas cost tracking adjustment. Several factors contribute to this conclusion. The Commission is disturbed that recent gas cost tracking applications have necessitated detailed

review of the Company's gas mix outside general rate cases. This defeats the purpose of an expedited proceeding and endangers close scrutiny of the Company's expenses. Current and foreseeable market conditions also indicate that prices have stabilized, eliminating the primary reason for a tracking adjustment. Finally, the imminent deregulation of wellhead prices will end the programmed monthly escalation of gas costs.

30. In order to mitigate the impact of the gas cost adjustments herein, the Commission finds that MDU's 12 month alternative amortization period should be implemented. No party has objected to this procedure.

#### CONCLUSIONS OF LAW

1. Applicant, Montana-Dakota Utilities Company, is a corporation providing natural gas service within the State of Montana and, as such, is a "public utility" within the meaning of Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates and operations. 69-3-102, MCA, and MCA, Title 69, Chapter 3, Part 3.

3. The Commission has provided adequate public notice of all proceedings and opportunity to be heard to all interested parties in this Docket. MCA, Title 2, Chapter 4.

4. The Commission is invested with full power of supervision, regulation and control of public utilities. 69-3-102, MCA.

5. A public utility seeking increased rates has the burden of showing its claimed expenses are reasonable. Montana Power Co. V. PSC \_\_\_\_Mont. \_\_\_\_ P.2d , 40 St. Rptr. 805; 809 (1983).

6. The rate level and rate structure approved herein are just, reasonable, and not unjustly discriminatory. 69-3-330, MCA.

### ORDER

1. Applicant, Montana-Dakota Utilities Company, shall file permanent rate schedules for natural gas service replacing temporary rates filed in this Docket that reflected the rates granted in Order No. 4993a. Rate schedules L increase rates to residential and commercial customers from Order No. 4993a levels by 5.54¢ per Mcf and 5.54¢ per Mcf for industrial customers.

2. These rates are to become effective for services rendered on and after December 19, 1983.

3. Rates will be filed in such a manner as to maintain the 25 percent rate differential between “winter” and “remainder of the year” rates.

4. In future gas cost tracking applications, MDU shall file an exhibit computing current gas cost tracking adjustments so as to reflect allocation of highest cost sources of supply to the category “Gas Subject to Cutback, Possible Sale, or MDU Storage.”

5. All motions and objections not ruled upon at the hearing are denied.

DONE AND DATED this 19th day of December, 1983, by a vote of 3-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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THOMAS J. SCHNEIDER, Chairman

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JOHN B. DRISCOLL, Commissioner

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DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill  
Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.